Public Sector Outsourcing: Creative Accounting or a Sustainable Improvement? – A Case Study for Austria

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The key rationale for public sector outsourcing is normally to improve public sector delivery as well as the state of public finances as defined by the Maastricht criteria. Like the underlying motives, the ensuing effects may also be diverse, however: increased business efficiency is generally accompanied by redistribution effects, and public sector outsourcing can affect the state's role as a service provider and may have implications for the state's stabilizing function. By the same token, the fiscal effects of such outsourcing are not always clear-cut. While the fiscal balance can typically be "improved" in the short term, the common fiscal indicators tend to become less meaningful as a result. The long-term fiscal effects of public sector outsourcing – especially, on long-term fiscal sustainability – have barely been researched. As a review of two Austrian outsourcing cases – BIG (federal facility management company) and ÖBB (Austrian Federal Railways) – shows, public sector outsourcing has a major impact on the assessment of fiscal sustainability without actually improving fiscal sustainability itself.

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In 1993, five criteria, including two fiscal criteria, were set out in the Treaty of Maastricht to ensure the macroeconomic stability necessary for a stable monetary policy in the euro area. The fiscal Maastricht criteria stipulate that annual government deficits must not exceed 3% of GDP and that government debt ratios must be less than 60% of GDP, or that they must be sufficiently diminishing and approach the reference value at a satisfactory pace. These two target values were regarded as ensuring sustainability and having a stabilizing effect in the sense that, given GDP growth rates at the time, government deficits not exceeding 3% of GDP might guarantee the stabilization of government debt ratios at 60% of GDP.

The Maastricht criteria, which also constitute the entry condition required for membership of the euro area, gave rise to increased consolidation efforts in most European countries. Thus, the euro area countries witnessed a sharp decrease in both government deficits and debt ratios, with the latter shrinking from 74% of GDP (1996) to 66.5% of GDP (2007). Against this backdrop, a number of studies have concluded that the Maastricht criteria were instrumental in improving fiscal sustainability somewhat.

However, these studies have failed to reveal the true causes of the (apparent) improvement in long-term fiscal sustainability as measured by the Maastricht criteria. Oftentimes, the fiscal constraints prompted governments to seek alternative solutions, such as outsourcing, to finance public sector functions. By outsourcing public sector functions to the private sector, governments may concentrate on fulfilling – and financing – their core functions. In addition to strengthening service delivery, public sector outsourcing has typically been aimed at improving the fiscal situation within the meaning of the Maastricht criteria.

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This transfer of public sector delivery to the private sector begs the question about the economic and statistical meaningfulness of the Maastricht indicators, i. e. about the integrity of public deficit statistics and, above all, of public debt statistics. After all, how meaningful is the fiscal sustainability information provided by the official general government accounts (based on the framework of the European System of Accounts (ESA) 95) if they fail to reflect a pronounced share of the government's long-term liabilities because the underlying services have been outsourced? Furthermore, it is difficult to assess the actual size of the general government sector, just as it is difficult to analyze the importance of this sector as an employer and infrastructure provider.

This makes it obvious that a discussion focusing only on the subject of "Improving the fiscal balance by outsourcing from the public to the private sector" will not do justice to a question of such complexity. This study will therefore attempt a more in-depth analysis of public sector outsourcing. Sections 1 and 2 introduce the subject of public sector outsourcing (reclassifications under ESA 95) by way of defining key concepts. Section 3 examines the motives for and the effects of such outsourcing/reclassifying, as achieving a healthy balance of multiple objectives, e.g. improving the efficiency of public sector delivery without retrenching public welfare, is not that easy. Furthermore, the analysis of the fiscal effects of reclassifications to the private sector takes into account their multidimensionality by breaking them down into short-term and long-term fiscal effects. Section 4 describes the impact of reclassifications on common fiscal indicators and provides an assessment of fiscal sustainability. Section 5 exemplifies the practice of reclassifying with two prime Austrian cases and analyzes its impact on both the fiscal balance and fiscal sustainability. Finally, section 6 presents the conclusions.

1 Public Sector Outsourcing and Privatization – Some Definitions

When it comes to transferring sovereign functions to the private sector or to contracting out public services to private providers, public economics makes a distinction between privatization and outsourcing. Both solutions generally diminish public sector influence in, or encourage private sector solutions for, public sector delivery.

1.1 Privatization

Privatization entails corporate conversion from public to private ownership. In most cases, this happens by selling a publicly owned enterprise to private investors. The government does not retain any operational risk or direct power of intervention in the enterprise's business operations. However, the government does retain the option to regulate some privatized enterprises – usually natural monopolies – through a regulatory authority. For instance, Austria's telecommunications sector is regulated by Telekom-Control.

1.2 Public Sector Outsourcing

In respect of public sector outsourcing, functions previously performed by government bodies (central, regional and local government authorities or other competent authorities) are transferred to an external organization. Public sector outsourcing in the legal meaning of the term is the conversion of government entities into enterprises that have a separate legal personality

under public or private law.[2] Unlike in the case of privatization, the general government in some form or other retains influence over outsourced entities, be it by specifying services, through financial ties or in its function as a (majority) owner. Depending on the articles of incorporation, the general government retains more or less distinct rights to give instructions that are exercised in day-to-day management and, in particular, in the (re)appointment of the supervisory and management boards. By way of outsourcing, it is possible to hand over direct responsibility for the areas concerned to the managers of these institutions without – as in the privatization of ownership – having to relinquish any influence in the future.

From an economic and institutional perspective, public sector outsourcing represents a middle way between delivering public sector functions directly and taking administrative reform so far as to privatize ownership. Key candidates for outsourcing are "activities of a business nature" (Gantner and Schneider, 1994). In these cases, the key rationale for outsourcing is to achieve greater organizational, financing and staffing flexibility in order to better implement given performance goals.

2 Reclassification as Defined by ESA 95

Reclassifications from the public to the private sector within the meaning of the European System of Accounts gained in importance particularly in connection with compliance with the Maastricht criteria requirements. The beauty of reclassification lies in the fact that the proceeds, costs and accumulated liabilities of reclassified units are not reflected in government deficit or government debt. Reclassifying activities to the private sector thus allows governments to realize quantitatively defined consolidation targets within the meaning of the Maastricht Treaty with relatively low political costs.

Reclassification pursuant to ESA 95 refers to the reclassification of institutional units – units having both autonomy of economic decision-making and their own accounting framework but not necessarily separate legal personality (which would be a condition for legal reclassifications) – between institutional sectors.

According to Stübler (2004), reclassifications from the general government sector pursuant to ESA 95 may, from a statistical point of view, qualify as either "true" reclassifications or as instances of regrouping.

2.1 "True" Reclassification

To determine whether an outsourced entity qualifies as having been reclassified to the private sector within the meaning of the ESA 95 definition, the following criteria must be reviewed:

1. First, it should be checked whether the reclassified unit is an institutional unit within the meaning of ESA 95. Pursuant to ESA 95 (Article 2.12), "*an institutional unit is an elementary economic decision-making centre characterized by uniformity of behavior and decision-making autonomy in the exercise of its principal functions. A resident unit is regarded as constituting an institutional unit if it*

[2] *"Public sector outsourcing, as defined here, requires outsourcing to legal personalities (under public or private law) other than central, regional or local government authorities. In the absence of separate legal personality, public sector outsourcing does not legally exist even if the entity concerned has decision-making autonomy in business matters." (Funk, 1994, p. 24). Reclassifications from the public to the private sector in the economic/ESA 95 meaning of the term are explained in section 2.*

has decision-making autonomy in respect of its principal function and either keeps a complete set of accounts or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were required. [...]" To qualify as an institutional unit it need not have a separate legal personality, but there must be a management layer with autonomy of decision in place, and this requirement must have been laid down in the unit's statutes (Mazegger and Stübler, 2002, p. 30).

2. Subject to the existence of an institutional unit, the next step is to establish whether this unit is a "market producer" or an "other nonmarket producer." In other words, the important thing[3] is whether sales cover more than 50% of production costs (intermediate consumption, compensation of employees, consumption of fixed capital, other taxes on production), or less. The prices for the goods and services of this enterprise must, moreover, be commercially significant (i.e. in line with the market).

The bottom line is that institutional units which are market producers are not classified in the general government sector.

2.2 Regrouping of Units

A unit is said to be regrouped if the outsourcing candidate remains integrated in the relevant government bodies' budget but otherwise fulfills the requirements for reclassification from the public to the private sector. Such units are called quasi-corporations.[4] Although it keeps a complete set of accounts and its economic and financial behavior corresponds to that of corporations, it does not have a separate legal personality.

In contrast to reclassifications in the legal meaning, reclassifications (or regroupings) from the general government sector (ESA 95 definition) do not depend on the condition of a separate legal personality. Examples of quasi-corporations are municipal water supply, sewerage and waste disposal businesses. However, outsourced units that qualify as instances of reclassification in the legal sense may remain an integral part of the general government sector (ESA 95 definition) if they do not satisfy the above criteria for reclassifications.

The rationale behind this sectoral framework is to exclude institutions or areas from the general government sector which pursue business interests, are largely cost-effective, and provide market services. In this way, a distinction is made between core public sector functions on one hand and the state's economic functions on the other hand, i.e. the market activities of general government (Fleischmann, 2002).

3 Effects of Reclassification

Reclassifications from the public to the private sector are by no means a recent invention of fiscal policy inspired by the Maastricht criteria. In particular, the federal government had resorted to off-budget solutions already in the four previous decades for a myriad of reasons. After the establishment of more widely known off-budget financing institutions such as the Austrian highway

[3] *See Articles 3.17 to 3.19, 3.32 and 3.33 of the ESA 95, as well as the "ESA 95 Manual on Government Deficit and Debt", 2nd edition, section I.1.*

[4] *According to the Budgeting and Accounts Regulation (VRV), quasi-corporations are the units cited in paragraphs 85 to 89 of the VRV.*

authority (ASFINAG), which was created in 1982, and prefinancing deals for the Austrian state holding company (ÖIAG) in the mid-1980s, the federal government outsourced a number of administrative functions to entities with a separate legal personality above all in the previous 1½ decades.[5] From the very onset, reclassifications to the private sector have sparked economic and social debates (Smekal, 1977; Van der Bellen, 1977). Although political analysis basically established that reclassifications to the private sector made economic sense in individual cases, a major drawback was noted nonetheless: that the enterprises in question would be largely removed from parliamentary oversight as a result.

3.1 Business Effects

The business rationale for public sector outsourcing and privatization will, as a rule, be the objective of remedying weaknesses imputed to the public sector such as inflexibility, inefficiency and the lack of transparency.

According to Schauer (1994), outsourcing offers the opportunity of implementing business strategies and running operations for profit. Outsourced units can reduce inefficiencies using modern tools of management and optimally manage (human, physical and financial) resources, thereby helping to improve allocative efficiency. In the area of staffing, public sector outsourcing opens up greater staffing flexibility and offers the opportunity to introduce performance-based remuneration and career development concepts. Furthermore, financing conditions change for outsourced entities: No longer having to abide by the annuality rule ensures continuity of financing in line with business requirements and increases or even facilitates internal and external financing possibilities.

According to an evaluation report prepared by the capital guarantee institution FGG (Strasser, 2003), all enterprises surveyed were able to raise their performance substantially in terms of per capita productivity following outsourcing. Moreover, most enterprises had good financial and net worth positions and a solid capital base. Leitsmüller and Rossmann (2001) attribute increased efficiency after outsourcing primarily to cost measures, which are mainly generated by cutting staff costs and boosting productivity. Leitsmüller and Rossmann, too, found the outsourced enterprises surveyed to be on a solid path in terms of their profit situation and resilience to crises.[6]

Furthermore, consumers of publicly delivered services should benefit from outsourcing as well. The transition from tax financing to schemes reflecting actual prices of services rendered or cost-covering rates normally weakens the fiscal illusion.[7] The oppor-

[5] *Fleischmann (2002) presented the following list of enterprises which were outsourced in the 1990s: Schönbrunn Zoo, Schönbrunn Palace, BIG, the Austrian Federal Financing Agency, ÖBB (1992 sui generis), Austro Control, the Austrian Environment and Water Management Fund, the Diplomatic Academy of Vienna, Post und Telekom Austria AG, the Austrian Securities Authority, Bundesrechenzentrum GmbH, Österreichische Bundesforste AG, Landwirtschaftliche Bundesversuchswirtschaften GmbH, the Austrian Rail Infrastructure Financing Enterprise (SCHIG), Bundestheater-Holding-GmbH, Österreichisches Forschungs- und Prüfzentrum Arsenal GmbH, Börsebeteiligungs-GmbH, Austrian State Museums, Bundessporteinrichtungen GmbH, the Federal Environment Agency Austria, Statistics Austria, the Spanish Riding School and the Piber Federal Stud. These enterprises were reclassified into legal persons governed by public or private law. Only a handful of those companies actually qualify as reclassifications within the meaning of ESA 95.*

[6] *In terms of capital adequacy and financial developments.*

[7] *Inaccurate representation of the fiscal burden with taxes and other general government revenues, and of the benefits from public sector functions/provision of services.*

tunity to bring costs in line with prices should result in an improved and more efficient match of supply and demand, as well as of costs and benefits. This is why cost transparency is of the essence. The calculation of cost-covering rates must be transparent and backed up by adequate data. Only then can cost-covering rates – unlike taxes – exert greater pressure on the cost structure of outsourced units, thereby contributing to a more efficient use of funds. If enhanced efficiency lowers costs and hence prices, the consumer's surplus would rise. Likewise, a competitive entrepreneurial environment should lead to more innovations being expedited to enhance product quality and boost efficiency.

3.2 Political and Economic Effects

To arrive at a balanced assessment of the effectiveness of outsourcing, it is necessary to evaluate not only the business side but also public welfare aspects and effects on economic stabilization activities. The switch from tax financing to cost coverage inherent in outsourcing will, as a rule, have distributional effects, affect the state's role as a service provider, and have implications for the state's stabilizing function.

As tax financing becomes less important than cost-coverage, the ability-to-pay principle[8] becomes less important than the benefit theory[9] of taxation. In outsourcing functions, the government should therefore prevent the financial exclusion of low income groups on account of cost-covering yet excessively high prices (Lehner, 2003). This is of the essence above all if outsourced units perform services of general economic interest. If such services are rendered by a body governed by public law, the conflict of goals between the provision of a service with profit-making intentions and the provision of a public service is resolved by the political process. For outsourced units, the loss of direct political influence on balancing interests must be offset by effective regulatory measures. If the aim of outsourcing is to create a commercial enterprise based on a private sector model, government subsidies must cover additional justified social policy functions. For reasons of transparency, the responsibility to provide services in the general economic interest should be clearly assigned and properly reimbursed.

Specific legal aspects pertaining to public sector outsourcing arise in relation to oversight by "public" administration. While public sector delivery is generally subject to parliamentary supervision, the management of outsourced public entities is not. In this respect, only the management of government stakes and the performance of public supervisory functions is still in the hands of the state. In contrast, the Austrian Court of Audit has much broader powers, extending to the bulk of outsourced entities namely to those entities which are considered to be in the public realm owing to the state's capital interests, influence and organizational integration (Funk, 1994, p. 38). Furthermore, the annual reports of outsourced units offer an opportunity for auditing that is beyond the purview of the democratic bodies of oversight.

Public sector outsourcing can also have a considerable impact on the gov-

[8] *In the case of the ability-to-pay principle, the tax amount is based solely on how much the individual person liable to tax is able to contribute to the public balance.*

[9] *In the case of benefit theory, tax is regarded as the price for public services that is derived from costs and individual benefits.*

ernment's function of stabilizing the economy. If, owing to outsourcing, the government loses its power of influence over enterprises – and, in particular, over their investment projects – its ability to stabilize the economy must be assumed to have weakened. However, the outsourcing body generally retains ties with the outsourced entity; the government usually remains the (sole) owner of outsourced enterprises and can thus continue to intervene – at least indirectly – in order to stabilize the economy.

Although public sector outsourcing does not necessarily reduce the scale of public sector investment, the number of investors and the coordination of investment activity do change however. The provision of public infrastructure in the widest sense is fragmented. For instance, most public works are now carried out by a variety of outsourced units. Building construction is under the remit of the public facility management company, BIG; road works and road maintenance (particularly highways) are carried out by ASFINAG; railway infrastructure investment by the also reclassified ÖBB; and hospital investment by the reclassified Austrian Hospital Fund. As a result, any investment that continues to be financed by the general government (federal government, state and local governments, social security funds) and thus affects the fiscal balance is very limited.

Although economic measures no longer show up (completely) in the general government's fiscal balance, investment by outsourced units remains a key instrument of economic policy. The government does retain a say in setting priorities in respect of infrastructure projects to be implemented, and in respect of their volumes. This is evident from the growth and location packages, the master transportation plan and, latterly, especially from the most recent government programs and the growth packages adopted in 2008 and 2009 to stabilize the economy in response to the financial crisis.[10]

3.3 Fiscal Effects

Since the introduction of the Maastricht criteria, the traditional aim of public sector outsourcing – to ensure a more efficient delivery – has been expanded to include the "desire for (at least, short-term) fiscal consolidation" and "fiscal cosmetics" (Stübler, 2003, p. 67). In order to facilitate Austria's entry to the euro area, the government deficit had to be reduced from almost 6% of GDP (in 1995) to less than 3% of GDP in 1997.

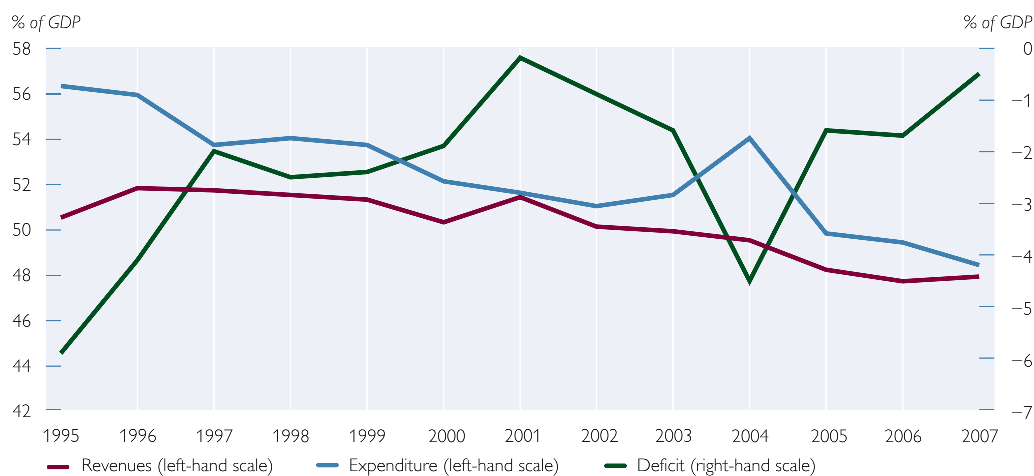
While state governments outsourced their hospitals in particular, local governments reclassified primarily their fee-based municipal services (water supply, sewerage, waste disposal, municipal real estate activities) into market establishments (quasi-corporations) (Fleischmann, 2002, p. 22f). Facility management has been outsourced at the federal and state level and, increasingly, also at the local level.[11] The federal government also outsourced highway works (to ASFINAG) and radically restructured the Austrian Federal Railways (ÖBB). Although these mea-

[10] *See Federal Chancellery (2008), p. 9 and p. 256.*

[11] *While the federal and state facility management companies are currently not classified in the general government sector, the municipal facility management companies qualify for this sector owing to the 50% criterion. In the case of hospitals, state governments resorted to granting hospitals loans to cover their deficits period from 2001 to 2007, under the presumption that, in line with ESA rules, such loans affected their debt ratio, but not their deficit. However, a Eurostat ruling of 2007 stipulated that those loans were understood to have increased the deficit as well.*

Chart 1

Development of the General Government Deficit Ratio, the Expenditure-to-GDP Ratio and the Government Revenue-to-GDP Ratio



Source: Eurostat.

sures influenced the fiscal indicators from the mid-1990s, they did so particularly in 1997, 2001 and 2004.

3.3.1 Short-Term Effects of Reclassifications

However, reclassifying public sector enterprises from the general government sector within the meaning of ESA 95 to the private sector does not per se have positive effects on either the government deficit or government debt. Reclassifying does not improve the fiscal balance if a reclassified unit's financing deficit continues to be offset by subsidies or capital transfers, which do affect the general government's fiscal balance.[12] However, if the reclassified unit finances any deficits it may incur itself (borrowing on the capital market, credit), then this deficit will not affect the general government fiscal balance, and the fiscal balance will improve thanks to the reclassification.[13]

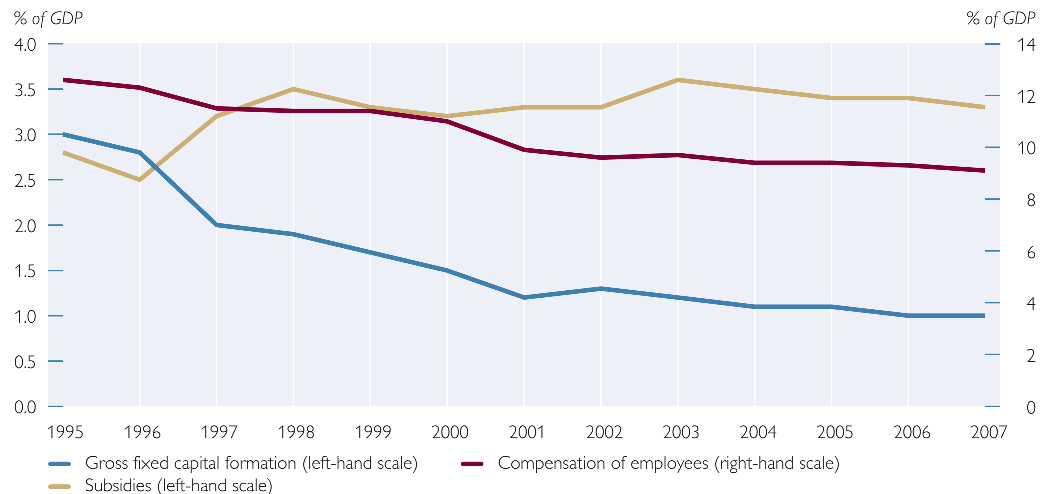
Stübler (2005) calculates reclassifications made in 2001 to have improved the fiscal balance by some EUR 1 billion (0.5% of GDP), of which 50% is accounted for by the privatization of public hospitals (through the establishment of commercial hospital operators) and 50% by the creation of quasi-corporations providing fee-based municipal services. However, this calculation is incomplete, as data on reclassified public undertakings other than quasi-corporations – for which ASFINAG is a prime example – are not available according to the ESA 95 concept, because these undertakings have, by definition, been removed from the budget of public entity that outsourced them. It is thus difficult to quantify what public expenditure (in a few cases, also revenues) these undertakings would have generated if they had still been classified in the general government sector. The annual reports (if available) of

[12] *In such case, the general government's fiscal balance reflects state subsidies provided to the reclassified unit, rather than the actual expenditure financing e.g. investment by the reclassified unit.*

[13] *These funds for self-financing can also come from the general government in the form of a loan or capital increase.*

Chart 2

Development of Gross Fixed Capital Formation, Staff Costs Including Imputed Wages and Subsidies



Source: Eurostat.

reclassified enterprises may give at best an approximate idea of the fiscal effects of these reclassifications pursuant to ESA 95.

Reclassification effects can be identified not only from the fiscal balance but from the individual balance items themselves. Even if reclassifications and regroupings are carried out such that the related transactions do not enter the budget result, they can cause time series breaks in individual expenditure and revenue positions.

The downward breaks in the time series for general government gross fixed capital formation and staff costs,[14] as well as the upward breaks for subsidies, are particularly evident. Based on ESA 95 figures, direct general government expenditure for gross fixed capital formation has been on a declining trend for years, dropping most sharply in 1997 (–0.8% of GDP, or –31%) and 2001 (–0.4% of GDP, or –21%). Likewise, general government staff costs fell by 0.8 percentage points in 1997 and by a further 1.1 percentage points in 2001. By contrast, general government subsidies rose by 0.7 percentage points in 1997. The dramatic changes in these fiscal components in 1997 and 2001 are explained by the reclassifications that were carried out. 1997 saw the reclassification of the highway authority (ASFINAG), of municipal market producers and of the regional hospital operators of those provinces that had already installed hospital operators. In 2000, the federal facility manager, BIG, was reclassified, and those provinces that had not already done so installed hospital operators in 2001. Since these companies are enterprises that are heavy investors and major employers, their reclassification made a significant dent in the respective ESA 95 time series.

The short-term effect of reclassifications (within the meaning of ESA 95) on debt is not always clear, either. If a unit is reclassified with its own debt, the level of general government debt drops accordingly. This alleviating effect was particularly substantial in

[14] *Compensation of employees according to ESA 95.*

1997, when ASFINAG's reclassification alone reduced the government's debt burden by some 3.1% of GDP. If, however, the government resorts to intermediate funding, i.e. issues bonds in its own name to provide financing for the outsourced units and thus remains the counterparty of the creditors who also bears the liability, such debt will continue to qualify as public debt.

Intermediary Funding Provided by the Central Government

Under an intermediary funding program running from 1998 to 2003, Austria's Federal Financing Agency used to borrow in financial markets by issuing bonds and relend the proceeds to enterprises reclassified to the private sector but still fully owned by the federal government, such as the highway authority, ASFINAG; the Austrian Federal Railways, ÖBB; the state holding company, ÖIAG; the rail infrastructure financing company, SCHIG) and Austro Control. This procedure was designed to benefit from Austria's AAA rating and ensured high liquidity for investors while offering them positive interest rate differentials ranging between 0.42 and 0.69 basis points from 1998 to 2002. At the same time, investors were duly informed with reference to Article 65c of the Federal Budget Act that the funds were raised for the benefit of federal enterprises, which undertook to pay the interest and principal to the Republic of Austria, which in turn met its corresponding obligations to its creditors. Since the increase in liabilities was offset by an increase in assets and the general government considered its role limited to that of an intermediary, this transaction was not seen to have had a debt-creating effect and hence not reflected in the government's debt level. However, a ruling by Eurostat (February 2003) suspended this practice, and any debt accumulated under the intermediary funding program had to be retrospectively included in the general government debt. The refinancing of such debt in the capital market has since continued – without the general government's intermediation –, thus leading to a gradual reduction of the public debt ratio.

3.3.2 Long-Term Effects of Reclassifications

Reclassifications from the public to the private sector can radically change fiscal volumes and the budget structure, which reduces the transparency of the fiscal balance in the medium to long term. Owing to reclassifications, most government investment is now carried out by businesses outside the general government sector. As a result, the government investment ratio pursuant to ESA 95 decreased from more than 3% of GDP in the early 1990s to a current 1.0% of GDP. Owing to absent data, however, it cannot be stated how high public investment (by the general government sector and government-controlled reclassified units) is. In the medium to long term, public sector outsourcing thus weakens the informative value of common fiscal indicators. In view of the inadequate data situation (Stübler, 2005), alternative fiscal indicators may be generated with only some difficulty. As a result, it will be increasingly more difficult to quantitatively assess the public sector's economic activities. At any rate, macroeconomic transparency will deteriorate although business transparency may be enhanced.

Furthermore, the debt ratio, which is used for assessing long-term fiscal sustainability, has only limited informative value. If reclassified businesses borrow themselves to finance their deficits, the debt incurred is not included in government debt pursuant to ESA 95. In the long term, such off-budget financing could incur liabilities for the general government if public guarantees exist for the underlying principal and interest expenses. Even if an explicit cover agreement does not exist and the

general government has assumed only the liability to obtain better financing terms, the general government could be forced to assume "gray financial debt" in the event of the reclassified unit's insolvency. In other words, in addition to its explicit liabilities, which are shown in the government debt, the general government also has implicit liabilities.

According to calculations of the Government Debt Committee (2008, p. 111), the minimum long-term liabilities held by the reclassified enterprises of central, regional and local government authorities in 2007 amounted to EUR 32 billion, i.e. some 13% of GDP. The bulk of this amount stems from entities reclassified from the federal government, such as ASFINAG (EUR 9.2 billion), ÖBB (EUR 9.3 billion) and BIG (EUR 3.3 billion). In contrast, the long-term liabilities of the hospital operators installed by the provincial governments are relatively low at around EUR 1 billion.[15] At end-2007, the minimum long-term liabilities of quasi-corporations amounted to EUR 10 billion.

4 Reclassifications, Fiscal Indicators and Sustainability

In principle, ESA 95 should be the ideal framework to compare fiscal indicators such as deficit, debt and individual revenue and expenditure categories. Reclassifications, which are by no means peculiar to Austria, significantly erode the informative value of fiscal indicators and their international comparability, however. The government's gross investment share of GDP is a case in point. In Austria, this share stands at around 1% of GDP, which is relatively low compared with other European countries (euro area average: 2.6% of GDP). However, if the investment of reclassified units (data situation permitting) is included for international comparison, total government investment is doubled.[16] The resulting increased government gross investment of 2% of GDP corresponds to international levels.

Similarly, assessing fiscal sustainability and its international comparability is rendered more complex through reclassification, as it is difficult to say whether reclassifying improves fiscal sustainability.[17] First, the effects of reclassifications are extremely multiple and varied. Second, assessment of budgetary effects as such requires careful judgment owing to the data situation and the web of ties between reclassified enterprises and their parent authorities.

Starting with Bohn (1998), studies on fiscal sustainability have investigated whether the primary balance reacts sufficiently[18] to an increase in government debt. According to Wierts (2008), these studies conclude that fiscal policy makes a sufficient contribution to debt stabilization and fiscal sustainability. This means that increased debt prompts greater consolidation efforts. However, the literature notes only a small improvement in fiscal sustainability owing to the Maastricht criteria.

[15] *The Carinthian hospital operator (KABEG) reported debt of around EUR 800 million alone.*

[16] *The investment expenditure of the ÖBB and Post und Telekom Austria AG is not included in this "increased gross investment expenditure" (Government Debt Committee, 2008).*

[17] *Long-term fiscal sustainability is defined in different ways by economic literature. A fiscal policy stance can be described purely intuitively as sustainable if there is no need for action in the sense of correcting this stance, i.e. the intertemporal fiscal constraint is respected.*

[18] *These studies regard as "sufficient" an increase in the primary surplus, which can offset the effects of the interest-growth differential on government debt, i.e. the intertemporal fiscal constraint is respected.*

Wierts (2008), however, criticizes these studies, as they use inaccurate and incompatible measures for both deficit and debt. In order to make the deficit and debt measures compatible, Wierts includes stock-flow adjustments (SFAs), which are defined as the difference between the government deficit and the change in government debt. These adjustments are frequently a sign of "creative fiscal accounting."[19] For studies on fiscal sustainability, SFAs are important insofar as it is possible to decrease the gross debt ratio without reducing the deficit through the disposal of assets. However, such transactions improve neither the net debt position of a state, nor its long-term fiscal sustainability.

Employing the net debt concept (gross liabilities less assets) and SFAs, Wierts attests that fiscal policy in EU countries was sustainable both before and after the Maastricht rules were introduced. However, fiscal policy following the introduction of these rules was less strongly focused on sustainability than before. In light of this finding, Wierts advocates widening the fiscal rules' current focus on the government deficit and gross debt to encompass an analysis of net debt.

Although Wierts' study takes the in-depth analysis of fiscal sustainability one step further, it fails to include the effects of public sector outsourcing on long-term fiscal sustainability. His study recognizes these effects only if they are reflected in SFAs. This is the case – if at all – only at the time of outsourcing. What is not considered are the transactions undertaken by the outsourced units following outsourcing. The study does not take into account how public sector outsourcing changes long-term fiscal sustainability by possible debt accumulation, which is an implicit government liability. Outsourced units' debt could burden the federal budget if the government is forced (owing to public guarantees or to insourcing) to service this debt.

The revised Stability and Growth Pact stipulates that a Member State's implicit liabilities should also be taken into account in future when calculating its medium-term fiscal target. This should help to safeguard long-term fiscal sustainability and to focus not only on short-term compliance with the fiscal rules. While the key concern in this respect used to be the implicit liabilities created by aging populations, on which considerable evidence has been gathered, little effort has been made to quantify the impact of public sector outsourcing on fiscal sustainability.

This situation may be attributable to the lack of an EU-wide database based on harmonized concepts. But comparability between EU countries is not the only problem. An in-depth assessment of fiscal sustainability is difficult even in individual cases (Leitsmüller and Rossmann, 2001). This predicament will now be illustrated by way of two prime case studies for the federal government. The first case study outlines the reclassification of the federal facility manager, BIG. The second analyzes the fiscal effects of restructuring the Federal Railways, ÖBB, a company which has already been classified outside the government sector.

[19] *Von Hagen and Wolff (2006) identified an incidence for the increased use of SFAs following the introduction of the EU's fiscal rules.*

5 Case Studies

5.1 Austria's Federal Facility Management Company (BIG)

Under the Federal Real Estate Act[20] of December 29, 2000, ownership of federal real estate of some 7.2 million m² of floor area[21] was transferred to BIG (founded in 1992) against payment of a basic fee of EUR 2.4 billion. It was agreed that BIG would pay this fee to the federal government in four tranches from 2000 to 2003 and that it would be financed by bonds issued by BIG. The transfer of ownership did not bring any changes to BIG's activities; it remained responsible for managing federal facilities. BIG's revenues were to be generated from economically significant, market-based (rental) fees of users (federal ministries, universities, schools). The rationale of the Federal Real Estate Act was to reorganize federal facility equipment and requirements within a reclassified unit on the basis of economic and market-based principles and to promote cost awareness among users. As before the transfer of ownership, BIG remains linked to the federal government by a close web of ties. It is, for instance, fully owned by the federal government, which appoints management and exerts its influence over its business operations. Owing to these close ties and the high probability that the general government would support BIG should it become insolvent, Moody's rating for BIG bonds is generally Aaa (Moody's BIG rating).

In a Eurostat ruling[22] of January 31, 2002, BIG was found to be a separate institutional unit, which must not be classified in the general government sector. BIG's liabilities therefore do not add to government debt. However, the government's proceeds from the sale of real estate to BIG were – owing to the specific structure of the transaction – booked *"not as a market sale but as a restructuring in the context of improved management of state-owned real estate"* (as explained in footnote 12). As a result, although the payments of the basic fee did not affect the fiscal balance, these revenues had a positive impact on government debt. The specific structure of BIG's reclassification, which was determined by Eurostat, is also reflected in SFAs of the period from 2000 to 2003.

Although BIG's gross debt has risen to EUR 3.3 billion since it was created, this debt is offset by considerable assets. In the medium term (until end-2010), a further rise to EUR 3.5 billion is expected even though new construction investment is subsidized. However, BIG's revenue stream is easily forecast owing to the enterprise's special user structure (98% are public sector tenants). In the long term, BIG intends to refinance funds borrowed to cover expenditure by charging fully cost-covering rents.

If BIG's rental revenues were to dry up for some reason or another (e.g. if the public sector were no longer to require BIG's premises), BIG would no longer be in a position to cover at least 50% of its operating costs by revenues. Under ESA 95 rules, BIG would then have to be reclassified to the general government sector. This means BIG's debt would then become government debt – to the order of its accumulated debt (some 1.2 % of GDP). However, such a scenario is not realistic owing to BIG's special ownership and user structure.

[20] *Federal Law Gazette No. 141/2000; Federal Real Estate Act.*

[21] *BIG annual report for 2000.*

[22] *Eurostat press release 15/2002 of January 31, 2002.*

Since BIG's reclassification has not changed the general government's net debt position (sale of real estate – debt reduction), fiscal sustainability should be assumed not to have changed either. However, a measure of fiscal sustainability reflecting only the current gross debt ratio could produce an inaccurate assessment of fiscal sustainability, as the gross debt ratio was positively impacted by BIG's reclassification. The fact that this reclassification has not significantly changed fiscal sustainability becomes all the clearer if one considers that the general government sector will reduce BIG's debt via rental payments and investment contributions in the long term.[23]

5.2 Austrian Federal Railways (ÖBB)

Unlike the two aforementioned federal entities BIG and ASFINAG, the ÖBB was outsourced already in the 1990s. This means it has generally influenced the fiscal balance (Maastricht definition) only indirectly owing to payments of federal government subsidies. This case study of its restructuring in 2004 (138th Federal Railways Structure Act 2003) reveals the implicit liabilities lying dormant in reclassified units.

As of the demerger reference date of January 1, 2005, the ÖBB was extinct in its previous form and transferred to the ÖBB Group under company law; and its employees, plants and functions were transferred to operational subsidiaries of the ÖBB Group. The ÖBB Group is fully owned by the federal government and holds shares in the subordinated companies belonging to the Group. These subgroups are: ÖBB-Personenverkehr (rail passenger company), Rail Cargo Austria, ÖBB-Infrastruktur Betrieb and ÖBB-Infrastruktur Bau (rail infrastructure development and maintenance). This ownership structure permits the federal government to appoint management and intervene in business operations. The federal government, therefore, still has the opportunity to pursue public stabilization and economic policies by stepping up investment, for instance.[24]

In the wake of this restructuring, the general government assumed the debt of the predecessor companies (ÖBB, SCHIG) to the tune of EUR 6.1 billion. In addition, the new ÖBB holding was provided with capital of EUR 1.4 billion by its owner, the federal government. In assuming said debt (EUR 2.9 billion attributable to ÖBB, EUR 3.2 billion attributable to SCHIG – which had been raised through intermediary funding by the central government) the general government waived the right to receive future interest and principal payments. Since, as this debt has – as intermediary funding – been regarded as government debt pursuant to ESA 95 since 2003, this transaction was accounted for in a way such that neither the government debt nor the government deficit changed. This accounting procedure was chosen owing to a preliminary assessment made by Eurostat. *("Preliminary assessment: based upon the limited information given by Austrian officials in all likelihood the liquidation of the current rail infrastructure enterprise SCHIG and the related*

[23] *The increase in BIG's rents is found in the government's program for the XXIVth legislative period under the heading "Growth Package" (p. 256).*

[24] *The government's program for the XXIVth legislative period deals with the ÖBB in the chapter entitled "Economic Policy".*

transfer of its debt to the Federal Government will not have an effect on Austria's budget deficit, nor on debt.")[25]

Statistics Austria booked the transfer of EUR 1.4 billion as a capital injection (i.e. equity participation and hence as a financial transaction), which did not increase the government deficit. This approach is acceptable as a rule, provided the investor can expect (improved) profitability and future dividend earnings from the enterprise or from the holding in the enterprise.

At first sight, the economic situation of the newly created holding does not look bad at all. The infrastructure development unit looks profitable in the period from 2005 to 2007, as it generated revenues from user charges for infrastructure and from its possession of power stations and real estate. However, the infrastructure maintenance unit closed 2006 with a loss. The transport units look essentially profitable, with only the passenger transport unit reporting minor losses.

However, a second glance at the ÖBB Group's key figures reveals that some of these positive results are attributable to payments made by the government. For instance, some EUR 1.6 billion of total sales revenues (around EUR 4.5 billion) comes from the federal government (approximately 36%). Of this amount, some EUR 580 million is allocated to transport units as compensation for social pricing (EUR 470 million to passenger transport) and environmental measures (EUR 110 million to goods transport). EUR 1.06 billion is allocated to the infrastructure maintenance unit, more than half of the latter's revenues (some EUR 2 billion). Furthermore, the return on equity was only around 3%, a level at which owners cannot generally expect a dividend.

Perhaps owing to this substantial government support, Eurostat announced in September 2008 that the ÖBB's capital increase in 2004 of EUR 1.4 billion would have to be reclassified as an investment grant, and that the cancellation of debt as part of the restructuring would have to be reclassified as debt write-off – i.e. as transactions affecting the government deficit. This accounting recommendation was made in line with accounting practice in other countries (Spain, Belgium, Italy), which had also cancelled debt during the restructuring of their railway companies. This ruling by Eurostat enhanced the international comparability and informative value of the Maastricht indicators. For Austria, this new accounting procedure pushes up the fiscal deficit for 2004 by EUR 7.5 billion from 1.2% to 4.5% of GDP, well beyond the European deficit limit of 3% of GDP.

In addition to these direct effects of restructuring remains the question about the extent to which the restructuring improved long-term fiscal sustainability. The Austrian Court of Audit (2007, p. 25) considers *"the declared key objective of railway reform to stabilize in the short term the need for funds of the ÖBB as a whole by improving efficiency and increasing its self-financing ratio and to reduce these requirements substantially by 2010"* as not having been achieved to date. Both federal payments (in the form of infrastructure contributions and payments for public service orders) and the ÖBB Group's liabilities have steadily risen since 2004. By 2010

[25] *Cited from Statistics Austria (2008): Public Finances and Maastricht Deficit National Accounts Revision 2008 Also Partly Concerns the Implementation of the ÖBB Reform in 2004.*
www.statistik.at/web_de/static/oebb-reform_2004_-_ausgaben_des_bundes_gemaess_esvg95_033333.pdf

liabilities are expected to reach EUR 17 billion. While the payments made by federal government show up in the government deficit, the government debt ratio is not affected by the ÖBB's debt. If, however, the ÖBB holding or one or more of its units no longer meet the ESA 95 criteria for reclassified units because of growing general government contributions, they would be reclassified to the general government sector, thus increasing the general government debt (Maastricht definition). As a result, the assessment of fiscal sustainability based on common measures would most probably change, albeit not materially.

6 Conclusions

ESA 95-related reclassifications from the public to the private sector generally imply a downsizing of the general government sector or a reduction in general government revenue and expenditure ratios to GDP, and they affect fiscal indicators. However, since the ties between the general government and outsourced units are usually very close, the latter essentially remain an integral part of the public sector in the economic and functional sense, and often even in the legal meaning.

Adequately considering these ties is particularly important in assessing the general government's actual fiscal, staffing and economic commitments. For instance, in recent years the Austrian government has repeatedly implemented growth and employment packages by boosting investment at units reclassified to the private sector, such as ÖBB, ASFINAG or BIG. Owing to the statistical reclassification of these units, however, the expenditure incurred is no longer directly reflected in the fiscal indicators of the general government sector. As a result, it is becoming more and more important to watch activities of reclassified enterprises. First, to assess public sector activities in terms of their economic and growth effects and, second, to analyze the extent to which allocation and stabilization functions are maintained. Since the transparency of macroeconomic results is deteriorating owing to reclassifications, the assessment of such activities is becoming more problematic.

At the same time, the Maastricht indicators are losing in informative value, and they are becoming harder to compare internationally. As the fiscal implications of public sector outsourcing can only be established in individual studies, it would be important to conduct more such studies in order to be able to accurately assess fiscal indicators in general, and indicators of fiscal sustainability in particular. This paper contributes two case studies to the literature: one on the federal facilities management company, BIG, and one on the Austrian Federal Railways, ÖBB. The evidence thus compiled illustrates how reclassifications from the public to the private sector can influence fiscal indicators and fiscal sustainability or, at very least, their measurement. It is therefore desirable that, with plans to include implicit liabilities in the calculation of a Member State's medium-term fiscal targets (as stipulated by the revised Stability and Growth Pact), adequate account is taken of implicit liabilities resulting from reclassifications to the private sector.

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